



## **Alternating Proprietors at Brewery Premises**

**To: Brewers and Others Concerned**

### ***Purpose of this Circular***

This Circular—

- Summarizes the existing policy of the Alcohol and Tobacco Tax and Trade Bureau (TTB) regarding the qualification and operation of alternating proprietors at breweries;
- Describes the differences between alternating proprietors at breweries and contract brewing arrangements;
- Outlines the procedures for brewers to follow when they apply for alternating proprietor arrangements;
- States TTB policy regarding alternating brewery proprietors that may be eligible to pay the reduced rate of tax;
- Defines the policy TTB applies regarding the continuing operation of existing alternating brewery arrangements, including instances when those arrangements are inconsistent with TTB guidelines;
- Announces that all previous approvals under 27 CFR 25.52(a) that allow operation as an alternating proprietor at a brewery no longer apply as of September 1, 2006; and
- Advises brewery proprietors who alternate premises to resubmit applications for alternate methods of operation if they intend to continue operating as an alternating brewery proprietor after August 31, 2006.

### ***Reason for Issuance***

We issue this Circular for two reasons. First, we want to provide guidance to brewers and others who wish to obtain under 27 CFR 25.52 TTB approval for a variation from existing regulatory requirements (alternate method or procedure) that would allow them to establish alternating brewery proprietorships. Regulations in 27 CFR part 25 do not expressly authorize these arrangements and provide no guidance for the establishment or operation of alternating brewery proprietorships.

Second, we want to resolve problems that we discovered through examination of applications at the National Revenue Center (NRC) and through field audits of operations. These problems relate to certain aspects of alternating brewery operations. Examples of

such problems include the splitting of beer production, contractual relationships, and the blending of beer. We believe some of these problems result from Bureau failure to state clearly Bureau guidelines for the operation of alternating brewery proprietorships. In this Circular, we provide guidance regarding the standards TTB applies for the establishment and continuing operation of alternating brewery proprietorships.

### ***Background***

The Homeland Security Act of 2002 brought TTB into being and resulted in the transfer of the revenue collection function and certain other duties of the Bureau of Alcohol, Tobacco and Firearms (ATF) to TTB. In this Circular, the pronoun “we” refers to TTB. Sections 7805 and 5051, among others, of the Internal Revenue Code of 1986 (the IRC) authorize the Secretary of the Treasury to administer requirements for qualifying a brewery, operating a brewery, and for paying tax and labeling beer removed from a brewery. The Secretary has delegated such functions to TTB. Regulations in 27 CFR part 25 implement the IRC beer provisions and include requirements on brewers that cover the production, removal, and taxpayment of beer. In those regulations, TTB sets out requirements for qualifying for the reduced tax rate for small brewers for which certain alternating brewery proprietors may be eligible.

### ***Contract brewing arrangement and alternating brewery proprietorship arrangement differences***

WHAT IS A “CONTRACT BREWING” ARRANGEMENT?

A contract brewing arrangement is a business relationship in which one person, such as a wholesale or retail dealer or a brewer, pays a brewing company, the “contract brewer,” to produce beer for him or her. The contract brewer is entirely responsible for producing the beer, keeping appropriate brewery records, labeling the beer with its name and address, obtaining necessary certificates of label approval (COLAs), and paying tax at the appropriate rate upon removal of the beer from the brewery. The contract brewer retains title to the beer at least until the beer is taxpaid or removed from the brewery. TTB considers contract brewing arrangements to be ordinary commercial arrangements.

WHAT IS AN “ALTERNATING BREWERY PROPRIETORSHIP”?

An “alternating proprietorship” is a term we use to describe an arrangement in which two or more people take turns using the physical premises of a brewery. Generally, the proprietor of an existing brewery, the “host brewer,” agrees to rent space and equipment to a new “tenant brewer.” The tenant qualifies as a brewer under part 25 by filing the appropriate documents with TTB. The tenant produces beer, keeps appropriate brewery records, labels the beer with its own name and address, obtains the necessary COLAs, and pays tax at the appropriate rate upon removal of its beer from the brewery. The tenant brewer has title to the beer at all stages of the brewing process.

Alternating brewery proprietorships allow existing breweries to use excess capacity and give new entrants to the beer business an opportunity to begin on a small scale, without investing in premises and equipment. Regulations in part 25 do not refer to this type of arrangement. However, in the mid-1980s, ATF began approving applications for alternate methods and procedures that allow two or more brewers to alternate the use of brewery premises and equipment.

WHAT DISTINGUISHES AN ALTERNATING BREWERY PROPRIETORSHIP FROM A CONTRACT BREWING ARRANGEMENT?

Significant differences between these two types of arrangements follow.

- *Title.* Section 5092 of the IRC (26 U.S.C. 5092) defines a brewer as a person who brews beer or produces beer for sale. In order to brew or produce beer, a person must first have title to the ingredients or raw materials, including unfermented wort. In a contract brewing arrangement, the contract brewer has title to the ingredients and to the beer during all stages of production. Ordinarily, the title to the beer passes to the person on whose behalf the beer is brewed only after production, taxpayment, and removal from the brewery.

In an alternating arrangement, the host and tenant brewer hold title separately to the ingredients or raw materials that they use and to the beer that they individually produce. Holding title to the ingredients or raw materials is essential in order for either the tenant or host brewer to brew or produce his or her own beer, as required by the definition of a brewer under section 5092.

- *Records and reports.* In a contract brewing arrangement, the contract brewer is responsible for keeping records of beer production and removal and for providing operational reports to TTB. The beer purchaser has no responsibility for records or reports under part 25, although that person may be required to maintain records as a retail or wholesale dealer in beer under 27 CFR part 31. In an alternating arrangement, the host and tenant brewer must keep separate records of their respective beer production and removals and each must provide operational reports to TTB.
- *Taxpayment.* In a contract brewing arrangement, the contract brewer is responsible for paying tax at the appropriate rate of tax on beer removed from the brewery. The person for whom the beer is produced has no responsibility to pay tax on the beer but may compensate the contract brewer for tax or any other expenses pursuant to the contract arrangement. In an alternating arrangement, the host and tenant brewer individually pay tax, at the rate of tax applicable to each, upon removal of their own beer from the brewery.
- *Qualification and permit status.* In a contract brewing arrangement, only one person, the contract brewer, must qualify as a brewer under part 25. The person on whose behalf the beer is brewed may be a wholesaler, a retailer, or another brewer. If this

person on whose behalf the beer is brewed under contract resells the beer to a dealer, then that person must hold a basic permit as a wholesaler under the Federal Alcohol Administration Act, and must comply with all applicable special tax requirements. In an alternating arrangement, both the host and the tenant brewer act as brewers and each must be qualified under part 25. The tenant brewer does not need to be qualified as a wholesaler, since the beer that the tenant produces is considered his or her own production and is not sold to the tenant by the host brewer.

### ***Alternating brewery proprietor eligibility to pay a reduced rate of tax on beer***

Title 26 U.S.C. 5051(a)(2) provides for a reduced rate of tax on beer for certain qualified domestic brewers. To qualify, a brewer must not produce more than 2,000,000 barrels of beer during the calendar year. The reduced rate of tax is \$7 per barrel on the first 60,000 barrels of beer that are removed for consumption or sale during the calendar year. Additional beer removed by the qualified brewer during that calendar year is taxed at the full rate of \$18 per barrel up to 2,000,000 barrels. Brewers who produce more than 2,000,000 barrels of beer in a calendar year are not eligible to pay tax at the reduced rate on any beer removed that year.

Under the eligibility requirement in section 5051(a)(2), a group of brewers under common ownership (referred to as a “controlled group”) are treated as a single brewer for purposes of determining eligibility to pay tax at the reduced rate. To be eligible to pay the reduced rate of tax, the controlled group cannot produce more than 2,000,000 barrels of beer collectively and must apportion the 60,000-barrel beer quantity eligible for the reduced rate of tax among the brewers who are members of the group.

Brewers who operate as tenant brewers at a host brewery may be eligible to pay tax at the reduced rate on the first 60,000 barrels of beer they remove in a calendar year if they—

- Do not produce more than 2,000,000 barrels of beer in a calendar year; and
- Are not members of a controlled group of breweries whose total production is more than 2,000,000 barrels of beer in a calendar year.

Qualification and what rate of tax is applicable to a host or tenant brewer are separate issues. However, TTB is concerned that some alternating brewery arrangements are efforts to split the production of a larger brewery into smaller businesses, in order to extend the reduced rate of tax to beer that might not otherwise be eligible for the reduced rate. TTB examines applications to establish alternating brewery proprietorships to determine if the applicant brewer is eligible to pay the reduced rate of tax on beer. Similarly, we examine existing alternating arrangements to determine if brewers who are paying the reduced rate of tax are eligible to do so. Although TTB may have approved certain alternating brewery arrangements in the past, the Bureau takes appropriate action if brewers who engage in an alternating arrangement are not entitled to pay, but are paying, tax at the reduced rate.

### ***Alternate methods and procedures***

An alternate method or procedure operates in lieu of a method or procedure specified in regulations. Authorization of alternate methods and procedures does not waive regulatory requirements. In the absence of a specific regulation, TTB has authorized alternations at brewery premises as alternate methods and procedures under 27 CFR 25.52(a). TTB may approve brewery alternations if they—

- Afford the protection to the revenue intended by the requirements of part 25;
- Do not hinder the effective administration of part 25; and
- Are not contrary to any provision of law.

Only the authorization of an alternate method or procedure in lieu of a method or procedure specified in regulations, such as recordkeeping, segregation of premises, and extension and curtailment of premises, makes an alternating brewery proprietorship arrangement possible. For example, alternating brewers do not file amended Brewer's Notices every time the premises are alternated to the use of another brewer, because records that show the status of the brewery at any time document this activity. TTB may revoke a previously granted approval, when conditions contrary to the conditions of that approval exist.

We emphasize that TTB cannot waive the statutory requirement that each alternating proprietor must actually produce beer. It is the responsibility of applicants for alternations to disclose all information necessary to determine that they will engage in bona fide beer production. Furthermore, approved alternating brewers must notify TTB if subsequent changes in their operations affect the conditions of their approval.

### ***Qualification of an alternating brewery arrangement***

In order to establish an alternating brewery proprietorship, both the host and tenant must be qualified as brewers and must file the information TTB needs to evaluate the alternating arrangement request. TTB must approve the brewers' qualifying documents and any necessary applications for alternate methods or procedures from existing regulatory requirements, in order to establish the alternating arrangement.

#### **WHAT DOCUMENTS MUST A HOST BREWER FILE WITH TTB?**

A host brewer must file the following documents with the NRC, in order to establish an alternating brewery arrangement.

- An amended Brewer's Notice, TTB Form 5130.10. The attachments to the Notice must describe the portion of the brewery premises and equipment to be periodically alternated and the tenant brewers with whom it will alternate. The amended Notice must include a diagram that identifies the areas that the alternating brewers plan to use. The host brewer must execute item number 14 of the Form, which includes a

determination of whether the host is a member of a controlled group of brewers that includes the applicant tenant brewer.

- An attachment to the Brewer's Notice that describes security at the brewery. This attachment is not necessary if the alternation does not result in any change to existing security information.
- A Consent of Surety, TTB Form 5000.18, that conveys consent to the periodic alternation of premises with the tenant brewer. Suggested language for the consent follows.

This consent extends the terms of the bond identified above to cover the operations as an alternating proprietorship between HOST at (list the brewery location—street, city, State, and zip) and TENANT, periodically suspending and resuming operations, in accordance with the procedures described in the Brewer's Notice.

- A request for an alternate method of operation from the requirements of 27 CFR 25.23(a) to permit use of the brewery for other purposes.
- A request for an alternate method of operation from the requirements of 27 CFR 25.78 to permit the use of brewery records as the record of extension and curtailment of brewery premises, in lieu of filing an amended TTB Form 5130.10 with each alternation of the brewery premises.

#### WHAT DOCUMENTS MUST THE TENANT BREWER FILE WITH TTB?

A tenant brewer must file the following documents with the NRC to qualify as a brewer and to establish a valid alternating brewery arrangement with the host.

- A Brewer's Notice, Form 5130.10, qualifying the brewery and describing the portion of the brewery premises and equipment to be periodically alternated with the host brewer. The Notice must include all attachments and organizational documents and must include a diagram that identifies the areas that the host brewer plans to use. The tenant brewer must execute item number 14 of the Form, which includes a determination of whether the tenant brewer is a member of a controlled group of brewers that includes the host brewer.
- A Brewer's Bond, Form 5130.22.
- A Consent of Surety, Form 5000.18, consent to the periodic alternation of premises with the host brewer. Suggested language for the consent follows.

This consent extends the terms of the bond identified above to cover the operations as an alternating proprietorship between

HOST at (list the brewery location—street, city, State, and zip) and TENANT, periodically suspending and resuming operations, in accordance with the procedures described in the Brewer's Notice.

- An attachment to the Brewer's Notice that describes security at the brewery. An amended copy of the host brewery's description may be sufficient.
- Environmental Information, TTB Form 5000.29, and Supplemental Information on Water Quality Considerations, TTB Form 5000.30. Amended copies of the host brewery's environmental forms may be sufficient, or the applicant may incorporate the host's environmental forms by reference in its application.
- Special Tax Registration and Return, TTB Form 5630.5.
- A request for an alternate method of operation from the requirements of 27 CFR 25.300(a), if the alternating brewer plans to prepare or store records on the premises of the host brewery.
- Power of Attorney, TTB Form 5000.8, if host brewery employees plan to prepare records or reports for the tenant brewer.
- A request for an alternate method of operation from the requirements of 27 CFR 25.78 to permit use of brewery records as the record of extension and curtailment of brewery premises in lieu of filing an amended Brewer's Notice, TTB Form 5130.10, with each alternation of the brewery premises.
- A request for an alternate method of operation to allow the establishment of an alternating proprietorship with the host brewer.
- A copy of the entire agreement between the host and tenant brewer.
- A business plan showing development plans for the brewing business.

The NRC furnishes copies of TTB forms that are necessary to qualify a brewery and can furnish sample copies of the requests for alternate methods or procedures necessary to establish an alternating brewery proprietorship.

***Bureau concerns about the qualification and operation of certain alternating brewery proprietor arrangements***

As noted previously, TTB has a number of concerns about the qualifications and operations of some alternating brewery proprietorships that we uncovered during field audits. These concerns include whether the—

- Tenant brewer is, in fact, acting as a brewer and producing beer.
- Tenant brewer is operating in a manner independent from the host brewer with respect to issues such as operations, production decisions, marketing, and beer produced.
- Alternating brewery proprietorship arrangement is primarily an arrangement designed to split production of the larger company into additional smaller companies, in order to improperly claim status as a small brewer and qualify for payment of the reduced rate of tax on beer or to enable the payment of the reduced rate of tax on a larger quantity of beer than would otherwise be possible.
- Tenant brewer is merely contracting the production of the beer to the host brewer or vice versa.
- Tenant brewer is in compliance with the conditions of the alternate method or procedure, including the requirements that the arrangement provide security to the revenue, be not contrary to law, and not cause an increase in cost to the Government or hinder the effective administration of part 25.

### ***Guidelines for alternating brewery proprietorships***

TTB wishes to facilitate the establishment of alternation operations at brewery premises, while at the same time protecting the revenue, ensuring that beer is properly labeled, and ensuring that proper records are kept. Therefore, the Bureau provides the following guidance regarding the standards that we apply in assessing the qualification and continuing operation of alternating brewery premises.

A discussion follows each of the guidelines to explain TTB policy. Failure by an applicant or a host or tenant brewer to adhere to one or more of these guidelines does not automatically result in the rejection of an application to alternate premises or in the revocation of an existing approved alternate method or procedure. TTB considers all relevant factors to determine whether to approve an application for an alternating brewery arrangement or whether an existing alternating brewery arrangement is consistent with TTB policy and the part 25 regulations.

- 1. Tenant qualification as a brewer.** The tenant brewer must qualify as a brewer with the NRC. In considering the qualifications and proposed operations of the tenant brewer, TTB carefully examines the terms of the agreement between the host and tenant brewer.

A clear indicator of an alternation arrangement is when there is an agreement between a host brewer and a tenant brewer providing for the rental or lease of brewery premises and the equipment with which a tenant intends to produce beer for sale. A “brewing services agreement” may also be used in an alternation arrangement when the tenant is paying the host for certain services relating to the



tenant's production of beer. A tenant may pay a host for its employees' services on a per-unit or per-time basis and a tenant may purchase raw materials from the host prior to brewing.

An agreement must not provide for pass-through payments to cover Federal excise taxes (FET). A pass-through is a payment provided in some agreements wherein one of the brewers reimburses the other brewer for the amount of the FET payment. TTB examines the agreement to determine if a host brewer is passing through FET payments to a tenant brewer or vice versa, a practice that may indicate that the host brewer is splitting production of its beer among one or more tenant brewers or that the arrangement is actually contract brewing.

- 2. Tenant operation as a brewer, not as a party to a contract brewing arrangement.** The agreement must indicate that the tenant operates as an actual brewer, rather than engages in a contract brewing arrangement. TTB considers whether the tenant holds title to the raw materials or ingredients prior to brewing. Further, we examine these agreements to determine whether beer is being sold or purchased by either brewer at any stage. TTB may treat the sale of beer by a host brewer to a tenant (or vice versa) during or after production of beer as an indicator of a contract brewing arrangement. Among other factors, TTB considers the following.

*Access to host premises.* TTB has found that in some agreements for alternating brewery proprietorships, host brewers require tenant brewers to agree to exclusion from brewery premises. If a brewer has no access to the brewery premises, then that person is precluded from actually producing beer and, thus, cannot meet the statutory and regulatory definition of a brewer as a person who produces beer for sale. TTB does not approve alternating brewery arrangements that include as part of the agreement a condition that prohibits access to the brewery premises by the tenant brewer or its employees.

*Business plan.* In determining whether an applicant is an alternating brewer or is instead entering into a contract brewing agreement, TTB considers the tenant brewer's business history, plans for development of future brewery assets, and level of commitment to the business, that is, investment in the business. Since the applicant is expressing interest in becoming a brewer, we look more favorably toward business plans that contemplate the opening of a brewery and the production of beer than we do toward business plans that only contemplate the marketing of beer. Business plans that are wholly concerned with the marketing of beer indicate a wholesale or contract brewing arrangement and do not indicate that a person is contemplating becoming a brewer and operating a brewery.

*Separation and identification of beer.* Each tenant brewer's beer must be separate and identifiable from the beer of all other tenants and host brewer at all stages, including prior to fermentation, during fermentation, during cellar storage, and as finished beer after production and before removal from the brewery. TTB

has discovered instances when beer produced by different brewers was not segregated at the brewery. In one example, a batch of beer was first brewed and then allocated among various tenant brewers. In a second example, the host brewed and stored beer and, only upon bottling, allocated beer to one or another of the tenant or host brewers. In a third example, beer produced by different tenant brewers was mixed or blended prior to removal from the brewery. In yet a fourth example, leftover tenant beer was returned to the host brewery.

In each of these examples, TTB could not trace in brewery records beer produced by a single brewer from raw materials, to fermentation, to removal from the brewery. Such practices hinder the effective administration of the beer regulations and increase the jeopardy to the revenue. Moreover, these practices make it impossible to distinguish between beer produced by the host and beer produced by one or more tenant brewers. Since it is not possible to segregate production of each tenant brewer, TTB considers all of the above instances as examples of *contract beer production* by the host brewer. If we discover instances like or similar to those cited above, we consider the beer to be made under contract by the host brewer and the host brewer to be liable for the tax at the applicable rate.

Finally, we view the blending of beer produced by different brewers as constituting the taxable removal of beer from one or more brewery premises to a different brewery. Under section 5051 of the IRC, this action triggers the immediate payment of excise tax on the beer.

*Records and reports.* The tenant brewer must keep records and submit operational reports, claims, and notices, as required by part 25. As a practical matter, TTB realizes that the preparation of records and reports may be contracted to host brewery employees. While this delegation is permissible pursuant to a power of attorney, TTB expects the tenant brewer to provide any requested brewery records and to be knowledgeable in discussing those records with TTB officers. Since each brewer is ultimately responsible for paying beer taxes, preparing records, and submitting operational reports, TTB believes that the actual tenant brewer must bear responsibility for his or her records and must be able to discuss those records and reports with TTB representatives. See also the paragraph titled "Representation" in item number six below.

*Taxpayment of beer.* The tenant brewer is responsible for taxpayment of beer at the rate applicable to that brewer. Liability for taxpayment cannot be delegated, although the preparation of tax returns may be delegated to employees of the host brewery pursuant to a power of attorney. TTB further notes that any pass-through of money provided in any agreement between a tenant and host brewer that is intended for the payment of Federal excise tax is a prima facie indication that one brewer is paying the excise tax for the other brewer. TTB considers such practice as an indication of a contract brewing arrangement, rather than an

alternating brewery arrangement and assesses tax based on the rate of tax applicable to the larger brewer.

- 3. Tenant brewer involvement and oversight of brewery operations.** The tenant brewer must be materially involved and must exercise oversight over brewery operations. TTB considers a number of factors shown below.

*Product development.* The tenant brewer must be involved in the development of the beer, whether by hiring a brewmaster, using its own formula, retaining a brewery consultant to develop formulas, or working with the host to develop formulas.

*Records.* The tenant brewer must maintain completely separate records of brewery operations from those of the host or other tenant brewers, and the records must relate only to the beer produced by the tenant brewer. Records must show the ingredients and materials purchased, the beer produced, the movement of beer throughout the brewery while it is in process, the beer removed from the brewery, the payment of taxes, inventories, and any other operations for which brewery records must be kept. The tenant may contract the preparation of these records to host brewery employees.

*Quality control.* TTB expects the tenant brewer to establish quality control standards and procedures that relate to the beer he or she produces at the host brewery. The tenant may—

- Employ a brewmaster to supervise the production of his or her beer;
- Establish procedures for overseeing the testing of the tenant's beer by the host brewer;
- Receive samples regularly of his or her own beer for testing and quality control purposes;
- Make regular or periodic visits to the brewery premises to oversee production, although the presence of a tenant brewer or tenant brewer representative is not required during the production of the tenant brewer's beer.

*Product liability.* Since the tenant brewer holds title to any ingredients prior to production and to its beer produced at the host brewery, TTB expects the tenant to be accountable for any risks or loss of beer during production. Accordingly, the tenant must be the party accountable for the actual risk of loss of beer or ingredients.

- 4. Independent tenant brewer operation.** Except in the case of controlled groups of brewers, TTB expects the tenant brewer to operate independently from the

host. If the host and tenant brewer operate in concert with each other with respect to brands, formulas, trademarks, marketing, or directed sales of beer to each other or to each other's customers, then TTB may conclude that the alternating brewery arrangement is merely a scheme to split production of beer produced by the larger brewer. In such a case, TTB considers the arrangement to be contract brewing and takes appropriate action, including assessing tax at the full rate and revoking approvals to operate under alternating brewery arrangements. TTB may take any other measure provided under the IRC and applicable regulations.

TTB carefully examines alternation agreements, business plans, formulas, labels and trademarks, and actual brewery operations to determine if the host and tenant brewers are, indeed, independent or if the alternating arrangement is merely a scheme to split the production of beer among brewers, in order to reduce the amount of tax to be paid. Among other factors, TTB considers the following.

*Production.* TTB expects the tenant to direct the production of beer at the host brewery. This means that the tenant should have customers or anticipate having customers to whom beer is to be sold. This also means that the tenant should receive orders from customers on which to determine the scheduling and amount of beer to be produced. This does not mean that the tenant must actually schedule beer production, but rather that the tenant provide input about the amount of beer to be produced based on orders or anticipated needs.

*Marketing.* TTB expects the tenant to have customers for whom the tenant is producing beer for sale and to market the beer separately and independently from the marketing of beer by the host or any other tenant brewers. We look unfavorably on applications for alternate methods of operations or procedures or on ongoing brewery alternations when the tenant brewer produces beer for a wholesaler owned or controlled by the host brewer or when the tenant produces beer for sale to a wholesaler on behalf of or at the direction of the host brewer.

*Restricting production relocation.* An independent brewer may produce beer at any suitable location. TTB does not approve an alternating arrangement that does not permit the tenant brewer to move production of its beer to another facility. If a tenant brewer is contractually prevented from moving production of beer to another facility, TTB considers the host and tenant brewers to be operating as a controlled group of brewers. We do not object to the contractual use of a brewery facility by a tenant brewer for a specified and limited period of time, but we do closely examine any agreement that limits or prevents the tenant from moving production to another facility.

- 5. Formula and label issues.** TTB examines the labels, trademarks, trade names, and formulas used by tenant breweries.

*Use of identical or similar labels, brand names, trademarks, or trade names.* We believe the use of identical or substantially similar labels, brand names, trademarks, or trade names by a tenant brewer and a host brewer *at the host brewery premises* may be evidence of a contractual agreement wherein the tenant brewer is producing beer for the host brewer. If this practice results in the splitting of production of the host brewer among one or more tenant brewers, TTB views the arrangement as contract production of beer by the host brewer and determines whether the payment of tax on such beer should be at the rate applicable to the host brewer.

*Sale or assignment of labels, brand names, trade names, or trademarks.* Similarly, TTB examines the sale or assignment of labels, brand names, trade names, or trademarks to a tenant brewer by the host brewer. The sale or assignment of such property may indicate an attempt to move production from the host to the tenant brewer or to split production of the host brewery among one or more tenant brewers. TTB examines the use of such labels, brand names, trade names, or trademarks and takes appropriate corrective action under the IRC and applicable regulations when such action appears to be an attempt to split the production of the host brewer's beer among tenant brewers. TTB exercises great care to examine sales when the host brewer retains the right to reacquire or take back a label, brand name, trade name or trademark, since this action suggests that the tenant brewer might not be operating independently from the host brewer.

*Formulas.* TTB examines formulas for beer produced by tenant brewers. Our concern regarding formulas is similar to that outlined above, that is, whether the tenant is operating independently from the host or whether the host is actually engaging in contract beer production. If we determine that the formula for beer produced by the tenant brewer is identical to that for beer produced by the host brewer or by other tenant brewers, we may consider that fact to indicate contract beer production by the host. However, we take into account all factors as previously outlined. For example, although a tenant's formula for beer may be identical to that of the host, if the beer brands, labels, trademarks, and marketing plan indicate a completely separate marketing arrangement, then TTB may not consider the use of identical formulas to be indicative of a contract brewing arrangement.

## **6. Additional alternating brewery arrangement conditions**

*Representation.* In the event that TTB conducts a conference with a tenant brewer, we require the presence of that tenant brewer. TTB does not allow the host brewer or its representative to appear at a conference on behalf of a tenant brewer. We do not object to a representative of the host brewer being present and giving advice to the tenant brewer at such a conference.

*Prepayment status.* Because of potential jeopardy to the revenue, TTB does not approve any new alternating brewery arrangements when the NRC has placed

the host brewer in prepayment status. We do not require that existing tenant brewers terminate agreements at such host breweries.

Similarly, we do not approve the participation of a tenant brewer at any alternating brewery premises, if the prospective tenant is currently in involuntary prepayment status at another location. In the event that TTB places a tenant brewer on prepayment status at any of its locations, we revoke any approved authorizations granted to the tenant, since we consider involuntary prepayment status to jeopardize the revenue.

*Limit on tenant brewers.* In order to not hinder the administration of 27 CFR part 25 or jeopardize the revenue, TTB reserves the right to limit the number of tenant brewers operating at the premises of a single host brewery.

*Use of host brewery employees.* Host brewery employees may engage in the production of beer at the brewery on behalf of the tenant. TTB recognizes that a tenant brewer may not find it practical or desirable to provide his or her own employees or brewmaster at the host brewery and does not expect use of tenant employees for beer production when this function is part of the agreement with the host. Exact terms and compensation must be specified in the agreement. Hourly compensation or a monthly rental may be provided, or the employees' cost may be part of a broader provision in the agreement that specifies the terms between host and tenant.

### ***TTB approval and compliance policy***

We continue to evaluate each application to operate an alternating brewery premises on its individual merits, based on factors that include the physical layout of the brewery premises to be shared, the compliance and business history of each applicant, and the likelihood that the alternation will take place without administrative difficulty or jeopardy to the revenue. We continue to review alternating brewery arrangements to ensure that brewers who pay the reduced tax rate are entitled to do so. We may instruct brewers to adjust their taxes if we find the reduced tax rate was applied in error and we do enter tax assessments when necessary.

Presently the sole official authorized to approve applications for alternating proprietors is the Director, NRC. The Director, NRC, uses the guidelines set forth in this Circular and applies them uniformly in evaluating applications for alternating brewery proprietorships. The Director, NRC, uses these guidelines collectively and not individually to determine whether to approve an application for an alternative method or procedure to permit operation of an alternating brewery premises.

This Circular serves as a restatement and clarification of TTB policy with respect to qualification and operation of alternating brewery proprietorships. Because we realize that we have not always effectively communicated our policy, we provide time for existing host and tenant brewers to come into full compliance. However, we will apply this policy to new

applications for alternating brewery proprietorships that are pending on or received after the date of publication of this Circular.

TTB affords existing qualified brewers who alternate premises an interim period, from the date of this Circular through August 31, 2006, to come into full compliance with TTB policy outlined in this Circular. As of September 1, 2006, TTB field personnel will apply the policies contained in this Circular when they conduct field audits and investigations. If appropriate, TTB plans to assess taxes at the full rate or to take other appropriate administrative action when we determine that:

- Brewers are not operating independently;
- Alternating brewery agreements are merely contract brewing arrangements; or
- Brewers have engaged in other actions that do not support their claimed eligibility to pay taxes at a reduced rate.

During the interim period referred to above, TTB intends to conduct field audits and investigations of alternating brewery proprietors in accordance with policies in existence at the time that we approved the alternation arrangements and to look at the operations of host and tenant brewers as outlined in existing agreements. TTB plans no tax assessments or other administrative actions against brewers who have received authorizations to operate and are operating in accordance with those existing agreements and the provisions of part 25. TTB does plan, however, to assess taxes, rescind approved alternate methods of operations or procedures, and take necessary administrative actions under the IRC and applicable regulations, during the interim period if the existing qualification or operation of the host or tenant brewer violates the conditions of existing approved alternate methods of operations or procedures.

***Rescission of existing alternate methods and resubmission of alternating brewery proprietorship applications***

In order to continue to be qualified and authorized to operate as an alternating proprietor at a brewery premises, all alternating proprietors must resubmit for approval their applications for alternative methods of operation under 27 CFR 25.52(a) by September 1, 2006. These include applications under 27 CFR 25.52(a) to alternate premises, to conduct other business on brewery premises (alternating brewery proprietorship), to prepare or store records and reports for another brewer, and to conduct any other activity that allows or expedites the operation of alternating brewery premises.

We require applicants to submit along with these applications a copy of the agreement between the host and tenant brewer. We also require tenant brewers to submit copies of their brewery business plans. Host brewers and tenant brewers must submit applications and other information for all locations at which they alternate premises with other brewers. It is not necessary to resubmit brewer's notices, brewer's bonds, qualifying documents,

environmental forms, or other documents if TTB already has them and the information contained in them has not changed.

We will evaluate these requests under the guidelines contained in this Circular, and we will approve requests for alternating brewery proprietorships when the qualification and operations will be in accord with these guidelines.

Alternating brewery proprietors who do not resubmit their applications under 27 CFR 25.52(a) for alternate methods of operations, or whose applications do not meet the guidelines in this Circular, will not have an approved alternate method of operation as of September 1, 2006. Although such brewers may have approved brewer's notices and bonds, as of that date they must operate according to all the regulatory requirements of 27 CFR Part 25, especially as to filing brewer's notices to alternate premises, using their own employees to prepare records and submit reports, storing records on their own portion of brewery premises, and complying with all other requirements contained in part 25.

We anticipate that the NRC will require at least one month to evaluate and approve each application, and we advise brewers to apply as early as possible in order to be assured that they will have approval to operate as of September 1, 2006. The NRC will respond to questions and inquiries concerning applications for alternating brewery proprietorships and will provide any necessary assistance in helping alternating brewery proprietors submit their applications.

#### ***Future TTB action***

TTB expects to engage in future rulemaking on the subject of alternating proprietors at breweries and plans to include appropriate transition rules. Any final rule issued on this subject supersedes this Circular.

#### ***Questions***

If you have questions concerning this Circular, contact the Supervisor, Brewery Applications Group, National Revenue Center, 550 Main Street Suite 8002, Cincinnati, Ohio 45202; Telephone 513-684-3337.

A handwritten signature in black ink, reading "John J. Manfreda". The signature is written in a cursive, flowing style with a large initial "J".

Administrator